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Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
National Telephone & Communications, Inc.	)	File No. ________
	)	
Petition for Partial Waiver of the Universal Service Contribution Requirements Under Sections 54.703, 54.709 and 54.711 of the Commission's Rules	))))	CC Docket No. 96-45

To: The Chief, Common Carrier Bureau

EMERGENCY PETITION FOR PARTIAL WAIVERS

National Telephone & Communications, Inc. ("NTC"), by its attorneys and pursuant to Section 1.3 of the Commission's Rules, hereby requests partial waiver of Sections 54.703, 54.709 and 54.711 of the Rules to allow NTC to exclude revenues attributable to a portion of its 1997 customer base for purposes of calculating its calendar year 1998 universal service contributions. Because the financial impact on NTC of current year USF contributions without the partial waiver requested are immediate, ongoing and severe, the Commission is asked to treat this petition on an emergency or expedited basis. In support thereof, the following is respectfully shown:

I. BACKGROUND AND STATEMENT OF FACTS

NTC resells intrastate and interstate interexchange services through a network marketing program of independent representatives who sell telecommunications services to retail customers. The company does not advertise or engage in direct sales of its services. NTC maintains communications with its independent representatives through a variety of means, including: NTC proprietary communications systems; internal personnel dedicated to the support of NTC's independent representatives; manuals, newsletters and other publications that are periodically sent to the independent representatives; and various training programs offered by NTC and its senior independent representatives throughout the United States.

NTC's discovery in 1997 that certain of its sales representatives had improperly marketed NTC services prompted NTC to undertake a comprehensive review of its internal policies and to implement revised procedures to ensure compliance with company guidelines for the marketing of services by independent agents.[1] The revised procedures have been effective, as evidenced by a dramatic decrease in consumer disputes, and NTC believes that they will serve to protect against a recurrence of such problems. In the process, however, NTC lost a significant number of sales representatives and, as a result, retail customers and sales. Over the past twelve month period, NTC's revenues subject to universal service contribution requirements under Section 54.703 of the Rules have dropped precipitously. After growing slowly in early 1997 from $8,650,029 in January to a peak of $9,809,139 in May, NTC's revenues began a dramatic and continuous month-by-month decline, reaching a low of $4,928,321 in May 1998. (See, Chart "January 1997 - May 1998 Total Revenues", Attachment A hereto.) Unfortunately, the timing of NTC's declining revenue stream coincided with the Commission's implementation of its new universal service contribution requirements pursuant to which NTC and other providers of interstate telecommunications services were required to begin submitting contributions in 1998 based upon 1997 revenues. As a result of this convergence of events, NTC's monthly universal

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[1] The revised procedures were incorporated in settlements, reached in October 1997 and February 1998, respectively, of two proceedings arising from the sales agents' actions: a civil consumer protection lawsuit with the State of California and an administrative action brought by the California Public Utilities Commission.

service contribution payments, considering its actual current revenues, are running at twice the level contemplated by the Commission under its contribution formula. Moreover, based on NTC's projections, the current revenue-USF payment imbalance will continue unabated throughout the remainder of 1998.

II. ARGUMENT

The financial crisis stemming from NTC's USF payment imbalance has become critical for NTC, not only putting it at an increasingly severe competitive disadvantage, but threatening the company's viability. Before the new USF contribution mechanism took effect, NTC's USF contributions, calculated at $0.51 per presubscribed line, averaged roughly $70,000 per month during the second half of 1997. NTC has calculated that its USF contributions for the second half of 1998 will be $277,667.70 per month, only slightly less than the roughly $295,000 per month contribution obligation incurred during the first half of the year. This manifold increase in NTC's USF obligation coincides with the dramatic drop in NTC's revenue between May 1997 and the present. Considering that the decline in NTC's revenues over this period was on the order of 50 percent, a simultaneous nearly four-fold increase in the company's USF obligation is proving more than NTC can handle. Even assuming the company's 1998 revenues do not continue their historic decline over the past 12 months, but stabilize at May 1998 levels, NTC's monthly USF contribution will be in excess of 5.5 percent of gross revenues. If the downward revenue trend continues, the ratio of USF contributions to revenues will steadily increase over the remainder of 1998.

NTC recognizes that Commission policy generally permits IXCs to pass on USF contribution costs in the form of higher rates to their customers. While NTC is able to recover a portion of its current USF contribution from subscribers, NTC estimates that at least $100,000 of its May, 1998 monthly USF contribution will not be able to be passed on to its reduced customer base. This is far more than can be absorbed in a business with relatively thin margins such as long distance resale. NTC is faced with an impossible dilemma. It cannot retroactively recover USF costs from the customers who actually received services during 1997 that have long since been billed and paid for, yet it is being assessed USF contributions based on its higher revenues from that period. At the same time, NTC is unable as a practical matter to pass on USF contributions it was unable to collect in 1997 to its existing diminished customer base and remain competitive. Even assuming the additional USF costs could be passed on to NTC's existing subscriber base, it would be unfair to burden existing customers in this manner. Moreover, NTC fears that further burdening its customers with such an extraordinarily high pass-through of USF contribution obligations will place NTC in a downward financial spiral in which it will lose more customers to other carriers, thereby diminishing the remaining customer base over which it may defray USF contribution costs, and further accelerating the loss of customers.

Further, while the FCC anticipated that higher USF contributions by IXCs would be offset, at least in part, by reductions in access charges paid by interexchange carriers, NTC has not benefited from such reductions to any significant degree. As a reseller, NTC receives no direct benefit from reductions in access charges underlying facilities-based carriers may receive, and NTC has experienced minimal rate reductions from its underlying carrier. Further, all such reductions have been passed on to NTC's customers. In fact, for competitive marketplace reasons, NTC's rate reductions have exceeded by a factor of between 2 and 4 any lowered costs to NTC provided by its underlying carrier.[2] NTC has been required, as a result, to bear essentially the full brunt of its USF contribution obligations since January 1998 -- obligations that are out of proportion to its revenues and realistic ability to pay.

The problem caused by the concurrence of NTC's 1997-1998 revenue decline and the inauguration of a new USF contribution mechanism based on prior year revenues is not simply a matter of short-term cash flow, but one which threatens the company's survival. During the period October 1997 through May 1998 the company suffered operating losses on the order of \$4.5 million. NTC cannot continue to incur operating losses of this magnitude without additional debt or equity financing, neither of which is immediately available. Compounding the problem, the loss of business suffered by NTC during the past year has also caused it to be in default under the minimum usage commitments under its agreement with its underlying carrier, WorldCom, Inc.[3]

The most recent 10-K filing for NTC's parent company, Incomnet, Inc. ("Incomnet") documents NTC's critical financial condition with respect to its operating losses, as well as its lack of ready access to either the debt or the equity financing that would be needed to fund such losses on a continuing basis.[4] Incomnet's SEC filing shows NTC has limited borrowing capacity

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2 NTC estimates it has received underlying carrier charge reductions in the range \$0.005 per minute while reducing its own rates by between \$0.01 and \$0.02 per minute during this time frame.

3 As of April 10, 1998, NTC was in default under its contract with WorldCom for approximately \$2 million for services and also had a \$4.3 million shortfall through February 28, 1998 on the "take or pay" provisions of the contract. NTC is in discussion with WorldCom to resolve these issues.

4 Annual Report of Incomnet, Inc. Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 (Form 10-K), filed April 15, 1998. In addition to its wholly-owned subsidiary NTC, Incomnet wholly owns Gensource Corporation, a company that designs, develops and markets computer software used for insurance-related claims administration, and owns 29 % of Rapid Cast, Inc., a company that manufacturers and markets a system that allows retail optical stores and wholesale optical lens manufacturing laboratories to produce single vision, flat-top bifocal and progressive bifocal lenses on demand, in approximately 30 minutes. As stated in

remaining on its credit facility with its principal lender (and, in fact, is in technical default on certain covenants of its loan agreement under which the outstanding balance of its credit line was \$8.24 million as of April 10, 1998) and that its only prospect for recapitalization is uncertain and, in any event, not imminent.[5] NTC has no other sources of capital to which it may turn at this time.

The unique circumstances faced by NTC should be found to satisfy the "good cause" standard of Section 1.3 of the Commission's Rules, demonstrating that the public interest would be better served by partial waiver than by full application of the USF contribution requirement in the special circumstances presented here.[6] Section 254(d) of the Communications Act of 1934, as amended (the "Act"), mandates that contributions to the Universal Service Fund are to be made by telecommunications carriers "on an equitable and nondiscriminatory basis." 47 U.S.C. § 245(d) (1996). The statutory language suggests that the Commission has a duty to exercise discretion in the application of the USF contribution requirement, applying it *equitably* by taking into account relevant facts and circumstances in particular cases. The Commission has rejected arguments that the USF contribution requirement is akin to an immutably applied "tax", and obviously the Section 254(d) universal service contribution requirement was not intended to be punitive. It would be neither equitable nor in the public interest for the Commission not to

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Incomnet's 10-K Report, however, 96.8 % of Incomnet's 1997 sales were attributable to NTC. Therefore, the financial information presented in Incomnet's 10-K filing reflects the financial condition of NTC.

5 In April 1998, Incomnet announced that it had reached an agreement to sell substantially all of the assets of NTC to NTC Acquisitions, Inc. a newly-formed unaffiliated corporation sponsored by Minneapolis, Minnesota-based John R. Dennis and Sire Capital Partners. Consummation of the asset sale is dependent upon numerous conditions precedent, and there is no assurance that the sale will, in fact, be consummated.

6 *Northwest Cellular Tel. Co. v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990); *WAIT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969), *cert. denied*, 409 U.S. 1027 (1972).

carefully consider a partial rule waiver where egregious factual circumstances, such as those presented here, threaten the viability of a business the loss of which would serve to lessen competition in the provision of interexchange telecommunications services.

Section 254(d) of the Act also required the Commission to establish a "specific, predictable and sufficient mechanism" under which providers of interstate telecommunications would contribute to the USF Fund. NTC recognizes that the Commission was required to implement Section 254 (as well as other revisions to the Act adopted under the Telecommunications Act of 1996) on a tight schedule, and has accomplished much in a short period of time in implementing these extensive regulatory changes. Given the short implementation time frame, however, it should also be recognized that in its initial stages the USF contribution process has generally imposed upon carriers requirements that were neither "specific" nor clearly "predictable", at least not until just prior to implementation. While USF contribution mechanics may at this point be fairly viewed as predictable on a going forward basis, the Commission should allow some degree of flexibility in the form of interim relief from extreme and untoward consequences of the program's initial implementation.

The Commission has in similar circumstances granted relief to ameliorate untoward initial effects of similarly dramatic regulatory changes (*e.g.*, protecting users from "rate shock" and applying its "fresh look" doctrine), particularly where it was determined that immediate application of such changes could adversely affect competition.[7] While the Commission did not

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[7] *Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd. 7369, 7463-64 (1992), *aff'd* 8 FCC Rcd. 7341, 7345 (1993) (existence of certain contracts with access arrangements of three or more years raised potential anti-competitive concerns in light of regulatory changes warranting that customers be given "fresh look" opportunities to terminate contractual arrangements); *Access Charge Reform,* 9 CR 932, 12 FCC Rcd 16606 (1997) (potential magnitude of rate impact of access charge tandem-switching rate element changes required four-step implementation over a two-year period to minimize the risk of "rate shock" and allow transport customers to

adopt a similar transition plan for the implementation of the new USF collection requirements to mitigate "rate shock" effects, its rationale for avoiding rate shock in transitioning the application of rule changes in other contexts -- including heading off threats to the "goal of a competitive market for interstate telecommunications services" -- applies here in support of NTC's waiver request.[8] Of course, in asking that the Commission consider its pro-competitive policies in the context of this waiver request, NTC does not suggest that the Commission has a responsibility to prevent individual competitors from failing. However, in the face of the growing trend toward consolidation within the industry, NTC asks that the Commission consider the untoward and unduly harsh effects strict application of its rules will have in the unique circumstances presented here, and recognize the direct, quantifiable and substantial consequences for NTC's continued viability as a competitive provider of telecommunications services if the rule waivers requested are not granted.

III. CONCLUSION

For all of the foregoing reasons, waivers of Sections 54.703, 54.709, and 54.711 of the Rules are requested to allow NTC to re-calculate its USF contributions for 1998 by excluding 1997 revenues exceeding corresponding period revenues during 1998; or, otherwise equitably

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adjust); *Investigation of Special Access Tariffs of Local Exchange Carriers*, 8 FCC Rcd 4712 (1993) (recognizing the short-and long-term benefits of a transition to mitigate rate shock were in the public interest).

[8] See, *Investigation of Special Access Tariffs of Local Exchange Carriers*, 8 FCC Rcd 4712 (1993).

> ". . . the Commission was concerned that a sudden shift from Settlement Agreement rates to cost-based special access rates would seriously compromise the OCCs' ability to provide services to many customers, thereby generating immediate and substantial negative effects in the telecommunications marketplace. Such a result could threaten the goal of a competitive market for interstate telecommunications services. The Commission, therefore, adopted a plan to gradually equalize the Settlement Agreement rates and full special access rates. Although the Commission recognized that any transition plan would generate a disparity of its own -- a gap between the rates paid by the OCCs and those paid by other customers, such as AT&T -- it concluded that, on balance, the short-and long-term benefits of a transition to mitigate rate shock were in the public interest." 8 FCC Rcd at 4713 (Footnotes omitted).

adjusting revenues reported on NTC's 1998 Universal Service Worksheets as deemed appropriate by the Commission.

Respectfully submitted,

NATIONAL TELEPHONE & COMMUNICATIONS, INC.

By: ______________________
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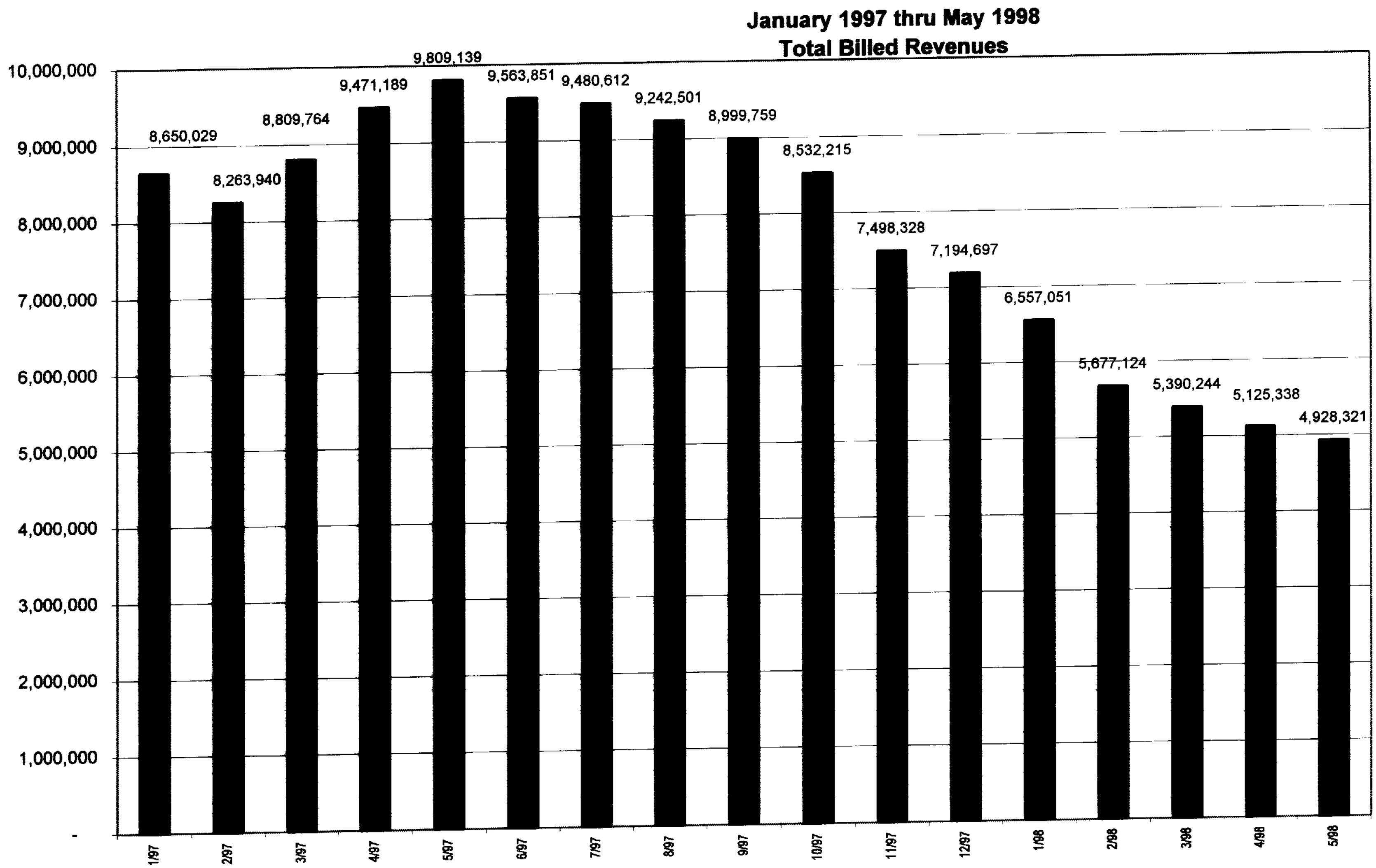
June 25, 1998

Attachment A



DECLARATION OF VICTOR C. STREUFERT

I, Victor C. Streufert, do hereby declare as follows:

1. I am Senior Vice President of Finance and Administration and Chief Financial Officer of National Telephone & Communications, Inc. ("NTC"). I am submitting this Declaration in support of NTC's Emergency Petition for Partial Waiver of the Federal Communications Commission's universal service contribution requirements (the "Petition").

2. I have read the Petition and hereby certify under penalty of perjury that the facts contained therein are true and correct to the best of my knowledge and belief.

Date: June 24, 1998.

Vict C. Streufert

Victor C. Streufert

CERTIFICATE OF SERVICE

I, Elizabeth A. Fertig, a secretary in the law firm of Gardner, Carton & Douglas, certify that I have this 25th day of June, 1998, caused to be sent by hand-delivery, a copy of the foregoing Emergency Petition for Partial Waivers to the following:

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